

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|-----------------------------------|---|---------------|
| THE APPLICATION OF R. A. WILLIAMS |) | |
| DEVELOPMENT COMPANY, D/B/A |) | |
| CEDARBROOK TREATMENT PLANT FOR |) | CASE NO. 8582 |
| AN ADJUSTMENT OF ITS RATE |) | |

O R D E R

On August 6, 1982, R. A. Williams Development Company, D/B/A Cedarbrook Treatment Plant, ("Cedarbrook") filed its application with this Commission to increase its rate pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). The proposed rate would produce additional revenue of \$6,322 annually, an increase of 139 percent. Based on the determination herein the revenues of Cedarbrook will increase by \$3,726 annually, an increase of 82 percent.

A hearing was not requested in this matter, and in accordance with the provision of the alternative rate adjustment procedure for small utilities no hearing was conducted. Therefore, the decision of the Commission is based on information contained in the application, written submissions, annual reports and other documents on file in the Commission's offices.

COMMENTARY

Cedarbrook is a privately owned sewage treatment system organized and existing under the laws of the Commonwealth of Kentucky, and serving approximately 54 customers in Harrison County.

TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1981, as the test period for determining the reasonableness of the proposed rate. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

The ARF was established to provide a simplified and less expensive method for small utilities to apply for rate increases with the Commission. Therefore, the financial data from the 1981 Annual Report is used as the basis for determining the revenue requirements. Cedarbrook proposed several adjustments to its test period revenues and expenses. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with certain modifications. In addition the Commission has made several adjustments to Cedarbrook's test period operating statement to reflect actual and anticipated operating conditions.

Operating Revenue

The actual operating statement of Cedarbrook for the test period reflected operating revenue of \$2,153. In response to item 6 of the request for information dated October 1, 1982, Cedarbrook indicated that its revenues were reported on the cash basis and thus included only cash receipts during 1981. Therefore, the Commission has increased operating revenue by \$2,383 to reflect normalized revenue based on the number of customers at the end of the test year.

Routine Maintenance Service Fee

Cedarbrook proposed an adjustment to decrease its routine maintenance service fee by \$840 annually. The proposed adjustment is due to a new maintenance service contract Cedarbrook entered into at the end of the test year. The new contract results in a reduction in the monthly routine maintenance fee of \$110 over the previous contract; however, Cedarbrook estimates that 2 hours of labor per month in addition to labor performed under the contract will be required, resulting in a net reduction of \$70 per month. In response to a request for the basis for the estimated 2 hours of additional work per month, Cedarbrook filed invoices for the first 11 months of 1982 which included actual costs under the new maintenance contract. In order to assess the reasonableness of the number of additional labor hours necessary, the Commission has reviewed the invoices submitted to Cedarbrook by the service company for the first 11 months of 1982 which reflected only 3 hours additional labor. Therefore, the Commission has determined that 1 additional labor hour per month is reasonable based upon the actual additional labor hours billed during the first 11 months of the new contract. Therefore the Commission has reduced Cedarbrook's annual routine maintenance expense by \$1,080.

Electric Expense

Cedarbrook reported test period electric expense of \$1,961. In order to assess the accuracy of the reported level of expense, as well as to determine the adjusted electric expense, the Commission

requested and Cedarbrook has supplied copies of its test period electric bills from Kentucky Utilities Company ("KU"). In reviewing the bills submitted the Commission has determined that Cedarbrook has included in the test period 2 bills for service outside the test period. In calculating the adjusted electric expense the Commission has removed the KWH usage from these 2 bills from the test period and adjusted test year electric expense to reflect the current rates in effect from Cedarbrook's electric supplier, KU. This results in an adjusted electric expense of \$1,831.

Repairs Expense

During the test year Cedarbrook purchased a new electric motor at a cost of \$180 and completely rebuilt one of its pumps at a cost of \$166. Both expenditures were included as operating expenses during the test year and reported in Account 713, Maintenance of Pumping System. Upon an analysis of the expenditures the Commission finds that the purchase of the motor should be capitalized and depreciated over its estimated useful life. In addition, the Commission finds that the expenditure to rebuild the pump is an extraordinary expense which cannot reasonably be expected to recur on an annual basis, and should be amortized over a reasonable period of time. Therefore, the Commission has reduced Account 713, Maintenance of Pumping System, by \$346 for rate-making purposes.

The Commission finds that this cost should be amortized over a 5-year period and has adjusted depreciation expense and amortization expense to reflect one-fifth of the total cost of these items.

Bad Debt Expense

Cedarbrook proposed an adjustment to include in its operating expenses bad debt expense of \$660. This adjustment was calculated by amortizing over 3 years Cedarbrook's uncollectible accounts more than 1 year old.

The Commission is concerned about Cedarbrook's level of uncollectible accounts in recent years. For the test year Cedarbrook's uncollectible accounts were \$2,383, or 53 percent of its total billings. The Commission in the course of its investigation requested an explanation of all steps taken by Cedarbrook to improve collection of its delinquent accounts. Cedarbrook's efforts to improve collections have consisted primarily of mailing a survey to up-date its billing records, telephone calls to customers, and notifying attorneys in the service area requesting that the sewer bill be deducted from the proceeds of the sale of homes when customers move. Moreover, Cedarbrook indicated that all of the customers whose delinquent accounts comprise the balance in uncollectible accounts at the end of 1981 are current customers of Cedarbrook.

The Commission is of the opinion that Cedarbrook has not put forth sufficient effort to collect its delinquent accounts. The continued reliable operation of Cedarbrook is contingent upon collection of the monthly rates for service on a timely basis. Therefore, management must pursue all means available to it to improve its collections including legal action in the small claims court. Cedarbrook cannot confirm that these accounts are uncollectible until it has made an effort to collect them.

Moreover, Cedarbrook should consider more stringent penalties within the regulations of this Commission for customers that do not pay in a timely manner to improve collections of past due accounts. The Commission is of the opinion that the paying customers of Cedarbrook should not be penalized through increased rates for the failure of the management of Cedarbrook to collect for the service rendered. Therefore, the Commission has disallowed the proposed adjustment for rate-making purposes.

Interest Expense

Cedarbrook proposed a pro forma adjustment to include interest expense of \$2,335. In calculating the pro forma interest expense Cedarbrook applied a 15 percent interest rate to the December 31, 1981, deficit balance in retained earnings of \$15,565. Cedarbrook stated in its application that Mr. Williams, President of Cedarbrook, had supplied funds to cover cash operating deficits from previous years of operations.

It is clear to the Commission that the delinquent accounts mentioned above comprise a material amount of this deficit. As noted in the preceding adjustment the Commission is not convinced that these accounts are uncollectible nor that Cedarbrook has made every effort to collect the accounts.

The burden of obtaining sufficient revenues to pay operating costs clearly rests with the management of Cedarbrook. The failure of Cedarbrook to seek sufficient revenues to cover its operating costs in prior periods does not justify the request in this case to recover these costs from the present ratepayers.

To allow Cedarbrook to recover the deficit balance in retained earnings or the interest charges thereon would constitute retroactive rate-making by this Commission. Therefore, we have excluded interest on the \$15,565 deficit in retained earnings for rate-making purposes herein.

P.S.C. Assessment

Cedarbrook proposed an expense adjustment of \$70 to reflect the increase in regulatory assessment expense resulting from the revenue adjustment for the proposed rate increase. The tax bills submitted by Cedarbrook and the Commission's records show that Cedarbrook paid the minimum 1981 assessment of \$50 for the Public Service Commission. Cedarbrook's revenues, including the increase granted herein, will fall well below the amount which determines the minimum assessment and thus Cedarbrook should continue to pay the minimum. Therefore the Commission has denied the proposed adjustment.

Rate Case Expense

Cedarbrook proposed a pro forma adjustment of \$250 to amortize the \$750 estimated cost of this rate case over 3 years. The \$750 included \$300 in legal fees and \$400 in consulting fees. The Commission has reviewed the information filed by Cedarbrook in this case and has found no evidence of outside legal services having been rendered to Cedarbrook. The application and all additional information have been filed by Mr. Williams. Further, the Commission is of the opinion that the information requested

by the Commission in this case should have been obtainable by Cedarbrook's staff without outside assistance. Therefore, due to the lack of evidence to support the \$300 legal fees included in the adjustment, the Commission has disallowed this portion of the adjustment, resulting in allowed rate case expense of \$450. Therefore, the Commission has included \$150 to amortize this cost over a 3-year period.

Income Taxes

Although Cedarbrook did not propose an adjustment for federal and state income taxes, the Commission has included a provision of \$225, based on the level of net income allowed herein and the applicable federal and state tax rates.

The Commission finds that Cedarbrook's adjusted test period operations are as follows:

| | <u>Actual Test Period</u> | <u>Pro Forma Adjustments</u> | <u>Adjusted Test Period</u> |
|-------------------|-------------------------------|----------------------------------|---------------------------------|
| Operating Revenue | \$ 2,153 | \$2,383 | \$ 4,536 |
| Operating Expense | <u>7,243</u> | <u>28</u> | <u>7,271</u> |
| Net Income | <u>\$(5,090)</u> | <u>\$2,355</u> | <u>\$(2,735)</u> |

REVENUE REQUIREMENTS

The Commission is of the opinion that the operating ratio⁽¹⁾ is a fair, just and reasonable method for determining revenue requirements in this case. The Commission has consistently used the operating ratio method to determine the revenue requirements of sewer utilities. In this case the Commission finds that an

$$(1) \text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenue}}$$

operating ratio of 88 percent will allow Cedarbrook to pay its operating expenses and provide a reasonable return to its owners. Therefore, the Commission finds that Cedarbrook is entitled to increase its rate to produce total annual revenues of \$8,262 which will require an increase of \$3,726 annually.

OTHER ISSUES

During the course of its examination of this request for rate relief, the Commission learned that Cedarbrook has filed this case and its annual reports of previous years on the cash basis accounting method rather than the accrual accounting method required by the Uniform System of Accounts and Commission regulations. The Commission hereby notifies Cedarbrook that it should file its annual reports beginning with the report covering operations for the 12-month period ending December 31, 1982, on the accrual basis in accordance with the Uniform System of Accounts for Sewer Utilities as required by 807 KAR 5:006.

SUMMARY

The Commission, after consideration of the evidence of record, finds that:

(1) The rate in Appendix A will produce gross annual operating revenue of \$8,262 and is the fair, just and reasonable rate to be charged in that it will allow Cedarbrook to pay its operating expenses and provide a reasonable surplus for equity growth.

(2) The rate proposed by Cedarbrook should be denied.

(3) Cedarbrook has not filed its annual reports with the Commission on the accrual basis as required by the Uniform System of Accounts.

IT IS THEREFORE ORDERED that the proposed rate in Cedarbrook's application be and it hereby is denied.

IT IS FURTHER ORDERED that the rate in Appendix A be and it hereby is approved for sewer service rendered by Cedarbrook on and after the date of this Order.

IT IS FURTHER ORDERED that within 30 days of the date of this Order, Cedarbrook shall file its revised tariff sheets setting forth the rate approved herein.

IT IS FURTHER ORDERED that Cedarbrook shall file its 1982 and all subsequent annual reports on the accrual basis.

Done at Frankfort, Kentucky, this 28th day of January, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8582 DATED January
28, 1983.

The following rate is prescribed for the customers in
the area served by R.A. Williams d/b/a Cedarbrook Treatment
Plant of Harrison County, Kentucky. All other rates and
charges not specifically mentioned herein shall remain the
same as those in effect prior to the date of this Order.

RATE: Monthly

All customers per connection

\$12.75